BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
JOHN H. AND OLIVIA A. POOLE)

Appearances:

For Appellants: Victor I. McCarty, Jr., Certified Public Accountant

For Respondent: Burl D. Lack, Chief Counsel; F. Edward Caine, Associate Tax Counsel

Amicus Curiae: Newlin, Tackabury & Johnston and Hudson B. Cox, Attorneys at Law

O P I N I O N

This appeal is made pursuant to Section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the claims of John H. and Olivia A. Poole for refund of personal income tax in the amount of $886.43 for the year 1951 and, pursuant to Section 18594 of the Revenue and Taxation Code; from the action of the Franchise Tax Board on the protests of John H. and Olivia A. Poole against proposed assessments of additional personal income tax in the amounts of $649.21 and $2,814.77 for the years 1352 and 1953, respectively.

During the years in question, Appellants were residents of California and derived income from sources in this state and in Minnesota. In California, Mr. Poole owned and operated radio and television stations. The expenses of this business exceeded the gross income therefrom in each of the years involved. Appellants received royalties from Minnesota iron mines and California oil wells, in addition to certain dividends, interest and rents. They realized gains and losses on sales of securities and other capital and noncapital assets., including real property in Minnesota and in California.

As residents, Appellants were subject to tax in California on their income from all sources. They were also subject to a Minnesota net income tax on income derived from that state.

Section 17976 (now 18001) of the Revenue and Taxation Code allowed a resident taxpayer to credit against his California tax

the amount of net income tax paid to another state, but in subdivision (c) limited the credit as follows:

> (c) The credit shall not exceed such proportion of the tax payable under this part as the income subject to tax in the other state . . . and also taxable under this part bears to the taxpayer's entire income upon which the tax is imposed by this part.

Expressed as a formula, subdivision(c) would appear thus:

$$\frac{\text{Income subject to tax in both states}}{\text{Income taxed by California}} \times \text{California tax} = \text{Maximum credit}$$

The controversy at issue concerns the computation of the maximum credit by the use of the formula, In their respective computations both Respondent and Appellants originally construed the word "income" as used in subdivision (c) to mean net income. On the theory that losses and expenses unrelated to specific items of income ratably decrease all items of income, however, Respondent considered Minnesota income subject to tax in California to be decreased by a pro rata portion of losses and unrelated expenses incurred in California, Since capital losses during the years in question were by statute deductible only to the extent of $2000, plus any gains from sales of capital assets (Rev. & Tax. Code, § 17717), Respondent apportioned $2000 of capital losses against all items of income and the remainder against all capital gains.

In Appeals of E. B. and Helen Bishop, Cal. St. Bd. of Equal., May 7, 1958, 2 CCH Cal. Tax Cas. Par. ZOC-879, 3 P-H State & Local Tax Serv. Cal. Par. 58121, we rejected the use of net income in the formula under subdivision (c) and held that for the purpose of the subdivision "income" subject to tax in Oregon was gross income before taking the deduction for Federal income tax allowed by the Oregon statute. In the wake of that decision Respondent and Appellants now appear to agree that "income" for purposes of Section 17976 means adjusted gross income, which for the years in question was defined in Section 17108 (now 17072) of the code, Respondent, however, continues its contention that pro rata portions of California losses and unrelated expenses are properly allocated to Minnesota income for the purpose of determining the extent to which that income is subject to tax in California. The effect of such allocations in the operation of the formula may be demonstrated by the following example, in which it is assumed that a resident taxpayer earns a salary in

California, incurs business and capital losses here, and derives capital gains and rental income from sources in another state.

		California return	Gther state return
Salary		$10,000	
Business - Gross	$50,000		
Expenses	55,000	(5,000)	
Capital gains		10,000	$10,000
Capital losses		(5,000)	
Rent - Gross	20,000		
Expenses	10,000	10,000	10,000
Adjusted gross income		$20,000	$20,000
Tax		$200	$200

To compute the amount of adjusted gross income from the foreign state subject to tax in California Respondent would allocate $3000 of the California capital losses against the capital gains in the other state and would allocate $\frac{17000}{27000}$ of the remaining California losses ($2000 + $5000) against the remaining items of Minnesota income, Thus its computation of the maximum allowable credit would be:

$$\frac{\$12,597}{\$20,000} \times \$200 \text{ (California tax)} = \$125.80$$

Appellants, *on* the other hand, would consider the entire Minnesota adjusted gross income to have been taxed in California and would compute the maximum credit as follows:

$$\frac{\$20,000}{\$20,000} \times \$200 \text{ (California tax)} = \$200$$

In Appeals of E. B. and Helen Bishop, supra, we discussed the extent to which the tax credit should alleviate the hardship of double taxation and stated:

> Where the taxes paid to the state in which the income was derived do not exceed the taxes paid to California and attributable to the same income, the credit allowed by Section 17976 will, if properly applied, reduce the California taxes to the full extent of the taxes paid to the other state. Since

> the total taxes paid to both states anti attributable to the same income will then exactly equal the tax which would have been paid to California if the income had been subject to tax only in this State, there is no double taxation of the same income.

That passage was intended to, and does, reflect our belief that under Section 17976 a California resident deriving income from another state with the same effective tax rates as California should not be taxed in an aggregate amount greater than the tax he would be required to pay to California if all of his income was derived from sources within this state. As demonstrated by the example set out above, Respondent's method of computing the maximum allowable credit fails to meet the test of this basic premise.

The application of complex and dissimilar net income tax laws to widely divergent factual situations hinders, and in some instances may preclude, the complete avoidance of double taxation by the device of a tax credit. The attainment of this objective, even within the practical limits of a single formula, has been further impeded under Section 179'76 by the absence of a definition of the word "income" as used in subdivision (c) in the phrase "income subject to tax in the other state... and aiso taxable under this part...." As Section 17976 is a remedial 'statute, however, we are firmly of the view that this ambiguity should be resolved by attributing to the-word "income" the meaning which will most fully effectuate the purpose of the legislation.

In our effort to reach an interpretation of subdivision (c) which will most equitably achieve the purpose of Section 17976 we have computed the tax credit in numerous potential factual situations by relating the word "income" to the different levels of income commonly recognized in net income tax Laws. We are satisfied that if "income" is construed to mean the equivalent of "adjusted gross income" as defined in the California Personal Income Tax Law the application of Section 17976 will substantially avoid discriminatory double taxation of the same income.

It is our conclusion that for the purpose of Section 17976 the entire amount of adjusted gross income received by Appellants from sources in Minnesota in each of the years in question and taken into account under the taxing statutes of both California and Minnesota must be included in the numerator of the formula under subdivision (c).

Appeal of John H. and Olivia A. Poole

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Sections 19060 and 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the claims of John H. and Olivia A. Poole for refund of personal income tax in the amount of $886.43 for the year 1951 and on the protests of John H. and Olivia A. Poole against proposed assessments of additional personal income tax in the amounts of $649.21 and $2,814.77 for the years 1952 and 1953, respectively, be modified by computing the allowable tax credits as prescribed in the opinion of the Board.

Done at Sacramento, California, this 1st day of October, 1963, by the State Board of Equalization.

John W. Lynch, Chairman

Paul R. Leake, Member

Richard Nevins, Member

Geo. R. Reilly, Member

_____, Member

ATTEST: H. F. Freeman, Executive Secretary